Carried Interest Debate Carried to Albany
By Christopher Faille, Senior Financial Correspondent
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ALBANY, N.Y. (HedgeWorld.com)—A bill newly introduced into the New York state legislature that would pave the way for city taxation of carried interest via unincorporated businesses is the work of Micah Z. Kellner, the assemblyman who represents the east side of Manhattan.

Mr. Kellner was elected to the assembly in a special election in June 2007 when the seat became vacant because his predecessor, Alexander Grannis, accepted an appointed position as commissioner of the Department of Environmental Conservation.

In a conversation on Monday [June 9], Mr. Kellner said that any time a New York municipality wants to change its system of taxation, it needs state authorization. An authorizing bill is introduced first, then the municipality sends a “home rule message,” asking that it be passed. Mr. Kellner seemed confident that a home rule message will be forthcoming on this issue.

He chiefly had private equity firms on his mind, although the language of his bill applies to hedge funds as well. “Private equity firms have been able to get away with not paying their fair share,” he said.

Asked whether such firms might not easily respond to such a bill by moving to Greenwich, Conn., or elsewhere, he said, “A few million dollars on their taxes isn’t going to be a killer,” especially since in his view they derive great benefits from a location in New York City, one of the world’s great finance cities.

The bill was introduced and referred to the Ways and Means Committee on June 4. It is drafted as an amendment to a provision of the law enacted in 1996, which stipulated that dividends and interest payments or “substantially similar income from ordinary and routine trading or investment” won't be deemed an unincorporated business carried on by the taxpayer.

That exception still applies, but Mr. Kellner's draft bill would create an exemption to the exemption, because income or gain “realized in connection with an investment management services interest, other than any portion thereof acquired by a contribution of investment capital, shall not be subtracted from the income of a business whose assets exceed $10 million.”
The Fiscal Policy Institute, a labor-backed think tank, advocated such a change in a report it issued in April. The FPI estimated at the time that the sort of change Mr. Kellner now proposes would generate between $165 million and $225 million for the city per year.

Opponents of such a measure see it as an unprincipled revenue grab [see previous HedgeWorld story, April 18, 2008]. In April E.J. McMahon, a senior fellow at conservative think tank The Manhattan Institute, said, “The UBT is a bad tax, and the last thing that New York City needs is to expand the UBT. It should be working to shrink the UBT.”

The prima facie “hit” upon partnerships from Mr. Kellner’s proposal would be 4% of the affected income. This would be somewhat mitigated, though, by the fact that the UBT can be deducted from federal taxes and can count as a credit toward city income taxes.